



**BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551**

**DIVISION OF BANKING
SUPERVISION AND REGULATION**

**SR 95-10 (SUP)
March 3, 1995**

**TO THE OFFICER IN CHARGE OF SUPERVISION
AT EACH FEDERAL RESERVE BANK**

SUBJECT: Payable Through Accounts

Background

Over the past year, Board staff has become aware of the increasing use of an account service known as a "payable through account" that is being marketed by U.S. banks, Edge corporations and the U.S. branches and agencies of foreign banks ("U.S. banking entity(ies)") to foreign banks that otherwise would not have the ability to offer their customers direct access to the U.S. banking system. This account service has also been referred to by other names, such as "pass through accounts" and "pass by accounts." We have worked with representatives from the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision to monitor payable through account activities and to ensure that all banking organizations supervised by the Federal Reserve and the other agencies are advised about the matters described below.

The payable through account mechanism has long been used in the United States by credit unions (e.g., for checking account services) and investment companies (e.g., for checking account services associated with money market management accounts) to offer their respective customers the full range of banking services that only a commercial bank has the ability to provide. The problems described below do not relate to these traditional uses of payable through account relationships.

Explanation of "Payable Through Accounts"

The recent use of payable through accounts as an account service being offered by U.S. banking entities to foreign banks involves the U.S. banking entity opening a checking account for the foreign bank. The foreign bank then solicits customers that reside outside of the United States who, for a fee, are provided with the means to conduct banking transactions in the United States through the foreign bank's account at the U.S. banking entity. Typically, the foreign bank will provide its customers, commonly referred to as "sub-account holders," with checks that enable the sub-account holder to draw on the foreign bank's account at the U.S. banking entity. The group of sub-account holders, which may number several hundred for one payable through account, all become signatories on the foreign bank's account at the U.S. banking entity.[\[See footnote 1\]](#) This results in individuals and businesses, who may not have been subject to the same requirements imposed on U.S. citizens or residents for opening an account at a U.S. banking entity, possessing the ability to write checks and make deposits at a U.S. banking entity, as if such individuals and businesses were the actual account holders at the U.S. banking entity.[\[See footnote 2\]](#)

It appears that some U.S. banking entities are not exercising the same degree of care with

respect to payable through accounts that they exercise for domestic customers that want to open checking or other types of account relationships directly with the banking organizations. Our experience has shown that some U.S. banking entities simply collect signature cards that have been completed abroad and have been submitted to them in bulk by the foreign banks, and then proceed to process thousands of checks issued by the sub-account holders, as well as other banking transactions, through the foreign banks' accounts at the U.S. banking entities. These U.S. banking entities undertake little or no effort independently to obtain or verify information about the individuals and businesses who use their accounts.

Possible Illegal or Improper Conduct Associated With Payable Through Accounts

The traditional use of payable through accounts by financial organizations in the United States (i.e., credit unions and investment companies) has not been a cause for concern by bank regulators. These organizations are regulated by federal or state agencies, or are otherwise subject to established industry standards; and they appear to have adopted adequate policies and procedures to establish the identity of, and monitor the activity of, sub-account holders--in essence the credit union's depositors or the investment company's mutual fund account holders. The same types of safeguards do not appear to be present in some U.S. banking entities that provide payable through account services to foreign banks.

Board staff is concerned that the use of payable through accounts by foreign banks at U.S. banking entities may facilitate unsafe and unsound banking practices and other misconduct, including money laundering and related criminal activities. Unless a U.S. banking entity is able to identify adequately, and understand the transactions of, the ultimate users--all or most of whom are off-shore--of the foreign bank's account maintained at the U.S. banking entity, there is a potential for serious illegal conduct. Recent reports from law enforcement agencies, as well as our own investigatory efforts, confirm that some money laundering and related illicit schemes have involved the use of foreign banks' payable through account arrangements at U.S. banking entities. Should accounts at U.S. banking entities be used for illegal purposes, the entities could be exposed not only to reputational risks, but also to serious risks of financial losses as a result of asset seizures and forfeitures brought by law enforcement authorities.

Guidelines on Payable Through Account Activities

Because of the possibility of illicit activities being conducted through payable through accounts at U.S. banking entities, we believe that it is inconsistent with the principles of safe and sound banking for U.S. banking entities to offer payable through account services without developing and maintaining policies and procedures designed to guard against the possible improper or illegal use of their payable through account facilities by foreign banks and their customers.

These policies and procedures must be fashioned to enable each U.S. banking entity offering payable through account services to foreign banks to identify sufficiently the ultimate users of its foreign bank customers' payable through accounts, including obtaining (or having the ability to obtain) in the United States substantially the same type of information on the ultimate users as the U. S. banking entity obtains for its domestic customers. This may require a review of the foreign bank's own procedures for identifying and monitoring sub-account holders, as well as the relevant statutory and regulatory requirements placed on the foreign bank to identify and monitor the transactions of its own customers by its home country supervisory authorities. In addition, U.S. banking entities should have procedures whereby they monitor account activities conducted in their payable through accounts with foreign banks and report suspicious or unusual activity in accordance with applicable Federal Reserve criminal referral regulations.

In those situations where (1) adequate information about the ultimate users of the payable through accounts cannot be obtained; (2) the U.S. banking entity cannot adequately rely on the home country supervisor to require the foreign bank to identify and monitor the transactions of its own customers; or (3) the U.S. banking entity is unable to ensure that its payable through accounts are not being used for money laundering or other illicit purposes, it is recommended that the U.S. banking entity terminate the payable through arrangement with the foreign bank as expeditiously as possible.

Notice to U.S. Banking Entities and New Examination Procedures

Because of the existing and potential problems associated with payable through accounts, we are asking that U.S. banking entities immediately begin to establish and maintain policies and procedures designed to guard against the possible improper or illegal use of their payable through account facilities, and that your Reserve Bank start to review such activities during the course of future examinations. To assist the banking organizations in your District with their understanding of our concerns in this area, we have attached a suggested letter to disseminate our payable through account guidelines to the state member banks, Edge corporations, and U.S. branches and agencies of foreign banks in your District. We have also developed new examination procedures that should be used by your examination staff to review payable through account activities. The new examination procedures will be sent to you under separate cover shortly.[\[See footnote 3\]](#)

After your Reserve Bank disseminates the attached suggested letter and begins to use the new payable through account examination procedures, we ask that, for the next six months, your examiners concentrate on reviewing U.S. banking entities' existing policies and procedures related to monitoring payable through account activities, to the extent that the banking organizations conduct such activities, and that they make suggestions for improvements or enhancements, where appropriate, consistent with our new guidelines in this area. Because the Federal Reserve, as well as other federal bank regulators, have not previously issued any guidance regarding the operation of payable through accounts at U.S. banking entities, we request that, until September 30, 1995, you focus on improvements and enhancements at U.S. banking entities where some deficiencies in this area are discovered and not include criticisms of U.S. banking entities' payable through account activities in your reports of examination. In addition, we request that your Reserve Bank not recommend any follow-up supervisory actions related to a U.S. banking entity's policies and procedures regarding its payable through account activities until the fourth quarter of 1995, unless your examiners find apparent violations of the Bank Secrecy Act or indicia of other serious criminal misconduct associated with such activities.

Collection of Data Related to Payable Through Accounts

Board staff is in the process of collecting data on payable through accounts in order to determine as soon as possible the extent of such activities in the United States. In this regard, please provide the following information to

Ronald J. Ranochak, Senior Financial Analyst, International Supervision Section, Mail Stop 182, as soon as such information becomes available through your upcoming examinations, contacts with U.S. banking entities following the dissemination of the attached suggested letter, or through other sources:

- 1. The name and location of each U.S. banking entity offering payable through accounts to foreign banks.**
- 2. For each such banking entity, as identified above:**

- a. the name, location and licensing authority of each foreign bank that maintains a payable through account, to the extent that such information is available at the U.S. banking entity;
- b. the ownership structure data on each foreign bank, to the extent that such information is available at the U.S. banking entity; and
- c. the number of sub-account holders in each payable through account, including the name and number of foreign banks that are sub-account holders.

In the event that you have any questions concerning any of the matters described herein, please contact

Richard A. Small, Special Counsel, at (202) 452-5235, or
Daniel D. Soto, Senior Special Examiner, at (202) 728-5829. For questions related to the collection of data on payable through accounts, Mr. Ranochak can be reached at (202) 452-5275.

Richard Spillenkothen
Director

ATTACHMENT TRANSMITTED ELECTRONICALLY BELOW

SUGGESTED LETTER

To the Chief Executive Officer of Each State Member Bank, Edge Corporation, and U.S. Branch and Agency of a Foreign Bank

Subject: Payable Through Accounts

Dear _____ :

Over the past year, the Federal Reserve has become aware of the increasing use of an account service known as a "payable through account" that is being marketed by U.S. banks, Edge corporations and the U.S. branches and agencies of foreign banks ("U.S. banking entity(ies)") to foreign banks that otherwise would not have the ability to offer their customers access to the U.S. banking system. This account service has also been referred to by other names, such as "pass through accounts" and "pass by accounts." We have worked with representatives from the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision to monitor payable through account activities and to ensure that all banking organizations supervised by the Federal Reserve and the other agencies are advised about the matters described below.

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It appears that some U.S. banking entities are not exercising the same degree of care with respect to payable through accounts that they exercise for domestic customers that want to open checking or other types of account relationships directly with the banking organizations. Our experience has shown that some U.S. banking entities simply collect signature cards that have been completed abroad and have been submitted to them in bulk by the foreign banks, and then proceed to process thousands of checks issued by the sub-account holders, as well as other banking transactions, through the foreign banks' accounts at the U.S. banking entities. These U.S. banking entities undertake little or no effort independently to obtain or verify information about the individuals and businesses who use their accounts.

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Federal Reserve staff is concerned that the use of payable through accounts by foreign banks at U.S. banking entities may facilitate unsafe and unsound banking practices and other misconduct, including money laundering and related criminal activities. Unless a U.S. banking entity is able to identify adequately, and understand the transactions of, the ultimate users--all or most of whom are off-shore--of the foreign bank's account maintained at the U.S. banking entity, there is a potential for serious illegal conduct. Recent reports from law enforcement agencies, as well as the Federal Reserve's own investigatory efforts, confirm that some money laundering and related illicit schemes have involved the use of foreign banks' payable through account arrangements at U.S. banking entities. Should accounts at U.S. banking entities be used for illegal purposes, the entities could be exposed not only to reputational risks, but also to serious risks of financial losses as a result of asset seizures and forfeitures brought by law enforcement authorities.

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maintaining policies and procedures designed to guard against the possible improper or illegal use of their payable through account facilities by foreign banks and their customers.

These policies and procedures must be fashioned to enable each U.S. banking entity offering payable through account services to foreign banks to identify sufficiently the ultimate users of its foreign bank customers' payable through accounts, including obtaining (or having the ability to obtain) in the United States substantially the same type of information on the ultimate users as the U. S. banking entity obtains for its domestic customers. This may require a review of the foreign bank's own procedures for identifying and monitoring sub-account holders, as well as the relevant statutory and regulatory requirements placed on the foreign bank to identify and monitor the transactions of its own customers by its home country supervisory authorities. In addition, U.S. banking entities should have procedures whereby they monitor account activities conducted in their payable through accounts with foreign banks and report suspicious or unusual activity in accordance with applicable Federal Reserve criminal referral regulations.

In those situations where (1) adequate information about the ultimate users of the payable through accounts cannot be obtained; (2) the U.S. banking entity cannot adequately rely on the home country supervisor to require the foreign bank to identify and monitor the transactions of its own customers; or (3) the U.S. banking entity is unable to ensure that its payable through accounts are not being used for money laundering or other illicit purposes, it is recommended that the U.S. banking entity terminate the payable through arrangement with the foreign bank as expeditiously as possible.

Even though we are asking that you begin immediately to establish and maintain policies and procedures designed to guard against the possible improper or illegal use of payable through account facilities, we understand that such new policies and procedures will take some time to implement fully. As a first step, you should contact each foreign bank that maintains any type of payable through account relationship with your banking organization in order to bring the records related to its accounts into conformity with the aforementioned guidelines.

Over the next several months, during our regular examinations, Reserve Bank examiners will be reviewing your existing policies and procedures related to payable through account activities, to the extent that you conduct such activities, any improvements or enhancements that you may make in light of the aforementioned guidelines, and your efforts, if needed, to contact foreign banks that maintain payable through accounts at your institution.

In order to provide your banking organization with sufficient time to implement our guidelines in this area, our examiners will not include criticisms of any U.S. banking entity's payable through account activities in reports of examinations until the fourth quarter of 1995. Also, we will not recommend any follow-up supervisory actions addressing deficiencies in this area until the fourth quarter of 1995, except in those situations where examiners find apparent violations of the Bank Secrecy Act or indicia of other serious criminal misconduct associated with such activities.

**Should you have any questions with regard to this matter, please contact
_____ at the Reserve Bank.**

Sincerely,

Footnote: 1 In a recent adaptation of the payable through account service, foreign banks have opened

accounts at U.S. banking entities and then solicited other foreign banks, rather than individuals, to use their accounts at the U.S. banking entities. These second tier foreign banks then solicit individuals as customers. This has resulted in thousands, rather than hundreds, of individuals having signatory authority over a single account at a U.S. banking entity.

Footnote: 2 Payable through account activities should not be confused with traditional correspondent banking relationships. Under typical correspondent banking arrangements, a smaller bank will enter into an agreement with a larger bank to process and complete transactions on behalf of the smaller bank's customers or the smaller bank itself. In such an arrangement, the smaller bank's customers are not aware of the correspondent banking relationships their bank has with other financial institutions. The smaller bank's customers certainly do not have access to their bank's account at the larger correspondent bank. This differs significantly from the payable through account situation where the sub-account holders have direct control of the payable through account at the U.S. banking entity by virtue of their signatory authority over the foreign bank's account at the U.S. banking entity.

Footnote: 3 It should be noted that the payable through account-related examination procedures will shortly become part of the new Bank Secrecy Act examination procedures that were recently distributed to the Reserve Banks.

Footnote: 4 In a recent adaptation of the payable through account service, foreign banks have opened accounts at U.S. banking entities and then solicited other foreign banks, rather than individuals, to use their accounts at the U.S. banking entities. These second tier foreign banks then solicit individuals as customers. This has resulted in thousands, rather than hundreds, of individuals having signatory authority over a single account at a U.S. banking entity.

Footnote: 5 Payable through account activities should not be confused with traditional correspondent banking relationships. Under typical correspondent banking arrangements, a smaller bank will enter into an agreement with a larger bank to process and complete transactions on behalf of the smaller bank's customers or the smaller bank itself. In such an arrangement, the smaller bank's customers are not aware of the correspondent banking relationships their bank has with other financial institutions. The smaller bank's customers certainly do not have access to their bank's account at the larger correspondent bank. This differs significantly from the payable through account situation where the sub-account holders have direct control of the payable through account at the U.S. banking entity by virtue of their signatory authority over the foreign bank's account at the U.S. banking entity.